EX PARTE OR LATE FILED

GTE

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July 18, 1996

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

EX PARTE: **Implementation of Local Competition**
CC Docket No. 96-98

Dear Mr. Caton:

Today I provided the attached letter and its attachments to John Nakahata of Chairman Hundt's Office and to others listed as receiving copies on the letter. This letter transmitted GTE testimony which was recently filed in California. The testimony is being provided in support of the position outlined by GTE in a letter to Chairman Hundt today. Chairman Hundt requested GTE's views on the Ohio Commission's approach

Please incorporate this letter and its attachments into the record of the above-captioned proceeding. Please call me if you have any questions.

Sincerely,

Whitney Hatch

Attachments

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Whitney Hatch
Assistant Vice President
Regulatory Affairs

GTE Service Corporation
1850 M Street, N.W., Suite 1200
Washington, D.C. 20036
202 463-5290

July 18, 1996

Mr. John Nakahata
Senior Legal Advisor
Office of Chairman Hundt
Federal Communications Commission
1919 M Street, NW
Washington, DC 20554

RE: Ohio PUC Avoided Cost Guidelines

Dear Mr. Nakahata:

Today Kent Foster sent the attached letter to Chairman Hundt in response to the questions he raised regarding the Ohio Commission's approach to determining avoided costs. In the letter, Mr. Foster indicated that we would provide you with more extensive testimony on this issue which GTE recently submitted in California. This testimony provides a more complete description of GTE's position than is contained in the letter to Chairman Hundt.

I will provide a copy of this letter and its attachments to the FCC Secretary. Please let me know if you have any questions.

Sincerely,

Whitney Hatch

Attachments
c: P. Belvin
J. Casserly
D. Gonzalez
R. Metzger
J. Schlicting
D. Sieradzki
R. Welch
FCC Secretary

Kent B. Foster
President

GTE Corporation

One Stamford Forum
Stamford, CT 06904
203 965-2123

July 18, 1996

The Honorable Reed E. Hundt
Chairman
Federal Communications Commission
1919 M Street, NW
Washington, DC 20554

Dear Mr. Chairman:

I appreciated your willingness to meet with me last week to discuss your interconnection and unbundling proceeding. It obviously is a busy time for you and the Commission.

One issue you mentioned at length was the challenge of determining an appropriate guideline for avoided cost in establishing wholesale rates for resale services. In particular you asked whether the decision adopted by the Ohio Commission could be applicable nationwide. As you know this issue is being considered by numerous Commissions throughout the country. Recently we filed information with the California Commission on the same issue, and I am providing the full text of our comments to your Senior Advisor, John Nakahata. We also recently filed a Petition for Rehearing before the Ohio Commission and intend to address the same concerns we describe in our attached California filing.

Briefly, both Dr. Selwyn, on behalf of AT&T and MCI in California, and the Ohio Commission recommend determining avoided costs by excluding certain Part 32 accounts. Ohio permits carriers to demonstrate that portions of these accounts should not be excluded as avoided costs, but the burden of proof is on the carrier.

GTE has not recommended the Commission adopt specific national guidelines in this area and should rather leave such determinations to the states and the negotiation process. However, if the FCC decides to proceed with specific national guidelines, GTE recommends developing a list of relevant functions actually avoided, after "netting out" both costs recovered from Nonrecurring Charges associated with the underlying activity (i.e., costs not included in the recurring rates to be discounted) and expenses associated with providing service on a resale basis. If the Commission adopts such an approach it should determine, in advance, which costs within each Part 32 account are avoided when providing resale services and which are not

For example: Accounts 6611 (Product Management) and 6623 (Customer Service), recommended by both Dr. Selwyn and Ohio for exclusion, include direct expenses associated with providing intermediary services to interexchange carriers. These are not retail functions. Product management expenses will not be avoided since a retail product must exist and be made available for resale. Further, while most sales expense will be avoided, some wholesale sales activity will be necessary. Thus, such expenses should be included in GTE's resale rates. Likewise, none of the costs recorded in Accounts 6621 (Call Completion Services) and 6622 (Number Services) can be avoided as these costs are associated with providing operator services, directory listings and directories. Whether GTE provides basic local service on a retail basis, or on a wholesale basis, the same costs are incurred in either scenario to provide operator and directory-related services to GTE local customers as well as the customers of local service resellers, as part of basic telephone service.

In summary, if the FCC decides to adopt national avoided cost guidelines, GTE recommends not adopting "whole cloth" the Ohio list of Part 32 Accounts without more specifically determining on a functional, and where appropriate subaccount, basis the actual functions and costs avoided in providing wholesale service.

I hope this is responsive to your request. Please let me know if you would be interested in additional details.

Sincerely,

Kent Foster

Kent B. Foster
President-GTE Corporation

KBF:cej

c: Commissioner Chong
Commissioner Ness
Commissioner Quello
Regina Keeney
FCC Secretary

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA
-oOo-

Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks.	)	R.93-04-003
Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks.	)	I.93-04-002

REBUTTAL TESTIMONY OF DOUGLAS E. WELLEMEYER

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REBUTTAL TESTIMONY OF DOUGLAS E. WELLEMEYER

I.

INTRODUCTION

Q. Please state your name and business address.

A. My name is Douglas E. Wellemeyer. My business address is 4100 North Roxboro Road, Durham, North Carolina.

Q. Have you previously filed testimony in this proceeding?

A. Yes, I filed testimony on behalf of GTE California Incorporated (GTE or Company) on June 14, 1996, and supplemental testimony on July 5, 1996.

Q. What is the purpose of this testimony?

A. The primary purpose of this testimony is to respond to the testimonies of AT&T Communications of California's (AT&T) and MCI Telecommunication Corporation's (MCI) witnesses Dr. Selwyn and Mr. Monighetti, especially with regard to certain "avoided cost studies" they have provided in this proceeding. In addition, my testimony responds to comments included in the testimonies of various parties regarding GTE's Avoided Cost Study, policy questions regarding the pricing of services offered for resale, resale restrictions, and finally GTE's wholesale NRC proposals.

II.

REQUIREMENTS FOR AVOIDED COST STUDIES

Q. Please distinguish between "avoided" versus "avoidable" as applied to GTE's avoided cost study.

A. No, I am not. On the contrary, I believe GTE's Avoided Cost Study is a "tops down" study of the type Dr. Selwyn properly argues is necessary and sufficient to satisfy the requirements of the Act. To my knowledge, GTE has never represented the study as a TSLRIC study.

Q. Dr. Selwyn asserts that "the federal Telecommunications Act of 1996 requires that ILECs set wholesale prices by excluding from their retail end-user rates all retailing costs that will be avoided <u>in the long run</u> when services are furnished to resellers on a wholesale basis." (AT&T/MCI, Selwyn, p. 12, ll. 1-4 (emphasis added).) Is this also your reading of the Act?

A. No, Dr. Selwyn has put his own spin on the requirements of the Act by including the phrase "in the long run." In his words, "the statute speaks of 'costs that <u>will</u> be avoided' (emphasis supplied), without placing any specific limitation upon the future time interval over which the ILEC must evaluate its avoided costs." (AT&T/MCI, Selwyn, p. 13, ll. 12-15.)

Q. Is this interpretation consistent with your reading of this part of the Act?

A. Not at all. As explained in the rebuttal testimony of Dr. David Sibley (p.p. 25-26), I believe Dr. Selwyn's emphasis on the "future time interval" is misplaced. As I read it, what this part of the Act requires is the identification of those costs that are certain to be avoided (<u>i.e.</u>, <u>will</u> be avoided) when retail services are offered instead on a wholesale basis for resale. The central issue here is not timing, but rather the avoidance of retailing costs.

Q. Dr. Selwyn answered "Yes" when asked whether other state Public Utilities Commissions have taken the view that a long-run approach is necessary when setting prices for resold services. (AT&T/MCI, Selwyn, p. 17, ll. 4-7.) Do you have any comment?

A. Based on his own discussion that follows, it appears that Dr. Selwyn's answer to this question should have been "No." Having answered "Yes," Dr. Selwyn cited an example based on unbundled services, which are subject to a different pricing standard under the Act than bundled services for resale, as he pointed out earlier in his testimony. (AT&T/MCI, Selwyn, p. 10, ll. 9-17.) He then admitted that he knows of no state commission that has determined how avoided costs should be calculated for bundled services offered for resale.

Q. Dr. Selwyn also claims that the Commission is compelled by its own existing costing policies to apply a long-run analysis of avoidable retailing costs to establish wholesale prices. (AT&T/MCI, Selwyn, p. 14, ll. 12-15.) Do you agree with this assertion?

A. No. Dr. Selwyn is referring with this statement to the Consensus Costing Principles adopted by the Commission in this proceeding. These guidelines were developed as a consensus definition of the requirements for developing service-specific TSLRICs for use as retail price floors. The same guidelines are not necessarily useful tools for every task that can be called a costing task, nor for the identification of avoided costs in particular.

According to an old maxim, "[c]osts are as costs are defined." As part of its charge under the Act to establish wholesale prices for services offered for resale, the Commission must establish appropriate policies and guidelines to define avoided costs. Based on the comments submitted by the Commission to the Federal Communications Commission (FCC) on the Notice of Proposed Rulemaking (NPRM),[1] this appears to be the Commission's intent.

Q. What are the key issues the Commission must address in establishing such guidelines for the identification of avoided costs?

A. There are at least five key issues to be addressed, all of which are raised in the opening testimonies of the parties in this proceeding: (1) the concept of net avoided costs; (2) the definition of avoided costs, and the distinction between the terms "avoided" and "avoidable"; (3) tops down versus bottoms up analysis methods; (4) to what degree, if any, service-specific identification of avoided costs is required; and (5) to what extent, if any, common

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[1] Comments of the People of the State of California and the Public Utilities Commission of the State of California on the Notice of Proposed Rulemaking, CC Docket No. 96-98, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, May 15, 1996 (hereinafter "California NPRM Comments"), [illegible]-39.

overheads are avoided.

Q. With respect to the first of these key issues regarding the concept of net avoided costs, Dr. Selwyn argues that there is no provision in the Act for an incumbent local exchange carrier (ILEC) to offset its avoided retailing costs by the costs incurred to provide service instead on a wholesale basis. Do you agree?

A. I strongly disagree with Dr. Selwyn's opinion, but part of my objection arises from the fact that Dr. Selwyn has not framed the issue clearly. There are actually two facets to this issue: (1) the LEC's one-time costs to implement wholesale provisioning processes; and (2) the LEC's ongoing wholesale "marketing, billing, collection, and other costs."

Q. What is GTE's position in regard to the first of these two points?

A. GTE's position is that wholesale implementation costs should be recovered in a competitively neutral manner, and include all necessary and reasonable costs incurred to establish wholesale provisioning capabilities.

Q. What is GTE's position in regard to the second point?

A. GTE's position, embodied in the Avoided Cost Study, is that the ongoing costs of all wholesale provisioning functions are properly attributed to resale services, and fully recovered through resale prices.

In my opening testimony, I referred to these ongoing costs as "substitute resale costs." Based on the definition of avoided costs that was provided by GTE witness Dr. Sibley, I established that avoided retail costs are equal to: (1) costs associated with displaced retail activities (affected retail costs); minus (2) added costs associated with replacement wholesale activities (substitute resale costs).

As an example, I pointed out that existing retail customer billing activities are avoided when a service is offered instead for resale, but a new wholesale billing function must be performed in its place; the avoided billing cost is the difference between the costs of these two activities. Said another way, the cost of the new wholesale billing function is properly attributed to the resale service, and recovered through the resale price.

Q. Have any other parties taken positions in this proceeding consistent with GTE's position on the treatment of these ongoing wholesale costs?

A. Yes. Sprint witness David Brevitz stated that "avoided cost is the sum of costs that are avoided plus the new costs that are incurred because of wholesale." (Sprint, Brevitz, p. 44, ll. 11-13.) Pacific also advocates the net avoided cost approach.

Furthermore, the Commission has noted that it is considering this issue, and that "[i]n recommending the use of a net avoided cost methodology, Illinois raises a relevant point. The concept of net avoided costs appears to provide an accurate estimate of actual costs avoided by the incumbent in wholesale provisioning of the service."[2]

Q. Hasn't Dr. Selwyn previously agreed with this approach?

A. Yes. In Dr. Selwyn's testimony on wholesale pricing methodology in the local competition docket (Vol. 16, TR 2918), he argued that he thought the costs were de minimis, but if there were any significant wholesale costs, they should be netted against avoided resale costs.

Q. Dr. Selwyn argues that "the determination of avoided retailing costs should also take into account relevant findings of the Commission's ruling on interim wholesale services rates." (AT&T/MCI, Selwyn, p. 21, ll. 1-2.) Do you agree?

A. Generally, I do not agree with this recommendation. I believe the Commission will use this phase, and succeeding phases, of this proceeding to establish permanent policies and guidelines governing the determination of avoided costs and the setting of rates for services offered for resale. I do not view the Commission's interim decision as binding or precedent-setting.

As Dr. Selwyn has observed, most of the proceedings leading to the Commission's interim order predated the implementation of the Act. Since then, broad consideration of the issues surrounding the implementation of local competition has been undertaken in the FCC's NPRM and in many other arenas. Therefore, blind adherence to the Commission's

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[2] California NPRM Comments, p.

interim decision is not necessarily well-directed.

Q. Dr. Selwyn alleges that a significant portion of common overhead costs will be avoided when services are provided to resellers on a wholesale basis, and that common overheads should therefore be included in the calculation of wholesale/retail expense factors. (AT&T/MCI, Selwyn, p. 22, ll. 6-9.) What are your comments?

A. As a point of order, there are no avoided cost components that should be determined by the application of a factor. Avoided costs should be determined by direct identification from the books and records of the LEC, as they were in GTE's Avoided Cost Study. The Commission's emerging guidelines for the definition of avoided costs should make absolutely no room for "wholesale/retail expense factors" other than for as part of a presumptive approach used as an alternative to a preferred, more refined methodology.

Q. Dr. Selwyn asserts that wholesale implementation costs should be borne by all retail providers, both resellers and GTE, "in proportion to each provider's respective market share." (AT&T/MCI, Selwyn, p. 19, l. 6.) Do you agree?

A. No. This position makes no economic sense since the incremental wholesaling costs are a direct result of providing wholesale services to resellers. Those costs would be avoided if the resale services were not provided. Since GTE's wholesale implementation costs are caused by the provision of wholesale services, according to cost causation principles, such costs should be attributed to resellers.

Q. Dr. Selwyn argues that local competition would be impaired if ILECs were permitted to recover wholesale implementation costs. Please comment.

A. As Dr. Sibley discusses in his Reply Testimony, this position is simply wrong. In contrast to Dr. Selwyn's assertion, inefficient entry would be encouraged if resale discounts did not reflect the incremental cost of providing wholesale services. When inefficient entry occurs, the average cost of providing telecommunication service to all customers necessarily rises. Thus, in the long run, consumers are made worse when they bear the cost of the wasteful investment through higher prices.

III.

<u>AT&T'S AND MCI'S AVOIDED COST STUDIES</u>

Q. Have you reviewed the avoided cost studies filed in this proceeding by Dr. Selwyn and Mr. Monighetti on behalf of AT&T and MCI?

A. Yes, I have. Dr. Selwyn has filed a study in this proceeding on behalf of AT&T and MCI which is much like the study he provided to the Commission last year during the local competition docket. Dr. Selwyn's study is a tops down study of the broadest nature, and is based on 1995 ARMIS data for GTE's California operations.

Mr. Monighetti has also filed an avoided cost analysis on behalf of AT&T. It is a tops down analysis as well, is equally high-level in its design, and is also based on the same ARMIS data. I have not had sufficient time to review Mr. Monighetti's study in the same depth as I have reviewed the other two studies. However, Mr. Monighetti has apparently attempted to develop separate avoided cost discount rates in his study for the private line, toll and local "lines of business".

Q. Why have you not investigated Mr. Monighetti's study?

A. There are several reasons. First, the study results reported in his testimony are so far beyond the bounds of reasonableness that little attention to the study seems warranted.

Also, Mr. Monighetti has not included sufficient study data with his testimony to undertake a meaningful investigation of the possible reasons for such unreasonable results. Only the "local" business unit results were provided with his testimony.

Finally, Mr. Monighetti's study does not appear to be composed in any manner that is materially different from Dr. Selwyn's studies, other than the additional level of cost allocations used to segregate avoided costs among the service categories.

Q. Dr. Selwyn claims the study he has presented is "substantially different from the original 'tops-down' model" (AT&T/MCI, Selwyn, p. 24, ll. 1-2) he presented in R.95-04-043/I.95-04-044. Do you agree?

A. No. Dr. Selwyn's analysis is essentially the same study he used before, although updated ARMIS data has been used. The study is also much like the analysis created by the Commission on the basis of Dr. Selwyn's prior study, as the basis for its interim resale discount rates.

Q. Dr. Selwyn claims he has updated his study to address the concerns that the Commission raised relative to the original model, and also based on the more detailed data filed in this case (AT&T/MCI, Selwyn, p. 24, ll. 9-16), and that the revised study benefits from additional "granularity" in the underlying source data. Is this true?

A. Dr. Selwyn appears to have undertaken some of this kind of analysis in preparing his study of Pacific's avoided costs. However, he has not used any of the detailed information filed with GTE's Avoided Cost Study in his further analysis of GTE's avoided costs; his study for GTE is no more detailed than the study previously provided to the Commission.[3]

Q. What is your overall assessment of the studies presented by Dr. Selwyn and Mr. Monighetti?

A. Dr. Selwyn's study, as well as the study presented by Mr. Monighetti, are both based on an inappropriate model of the wholesale LEC operating structure that can be expected to serve the wholesale market. Because of this improper foundation for the studies, the results are not representative of costs that can reasonably be expected to be avoided, and

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[3] Dr. Selwyn has summarized much of the detailed workcenter cost analysis filed with GTE's Avoided Cost Study in his testimony attachment Table 7, but none of this detailed information has been used to improve his estimates of GTE's avoided costs.

the studies must therefore either be ignored by the Commission or substantially modified.

As discussed later in my testimony, Dr. Selwyn's avoided cost studies, when corrected, may be useful to the Commission as benchmarks with which to gauge the validity of more refined avoided cost study results such as those provided by GTE in this proceeding. I have prepared an analysis that addresses the required corrections to Dr. Selwyn's study.

Q. Would you please explain why you believe the AT&T and MCI studies are based on an inappropriate wholesale model?

A. Yes. Both studies attempt, as explained by Dr. Selwyn, to "analyze avoided retailing costs by identifying precisely those costs that the incumbent LEC would no longer incur <u>were it to exit the retail services market entirely</u>." (AT&T/Selwyn, p. 5, ll. 1-3 (emphasis added).) This definition of the avoided cost problem is in direct conflict with Dr. Selwyn's own definition of wholesale basic services offered for resale: "the provision of <u>bundled</u> services by the incumbent LECs that are similar in character and composition to the carriers' existing retail services."

Q. Doesn't Dr. Selwyn's definition demonstrate that a retail product line is a prerequisite to resale?

A. Yes. In fact, if the LEC retail services do not exist, then there is no bundled product for the LEC to offer for resale. This understanding is also implicit in the resale requirements of the Act, when it states that any service offered on a retail basis by the to an end-user customer must also be offered at a discount for resale. The retail product must first exist before there is anything that can be offered for resale.

As discussed by Company witness Dr. Sibley, it is patently unrealistic to assume that GTE will be driven to exit the retail services market entirely. Consequently, a model that assumes GTE will exit entirely from the retail services market will likely lead to faulty assumptions about the retail costs that can reasonably be expected to be avoided, when part of GTE's existing retail services are provisioned instead on a wholesale basis for resale.

Q. Can you give an example of how the "exit retail" model will lead to faulty study assumptions about avoided costs?

A. Yes. There are two very good examples discussed at greater length later in my testimony: product management expenses, and product advertising expenses. I'll use product advertising for this example. If GTE were to exit the retail market entirely for all products, I would expect retail product advertising to cease, and I might view product advertising expenses as avoided in that scenario.

But this is not what is actually expected to happen. Assume that resellers can reasonably be expected to capture twenty percent of GTE's present retail market. The question is, what product advertising costs are avoided as a result of the need to provision a part of the retail service on a wholesale basis instead, for resale? I expect that there would be no reduction in product advertising expenditures under this scenario, so there can be no avoided product advertising costs.

Q. What is the question that needs to be answered by a properly conducted avoided cost study?

A. The proper question to answer with an avoided cost study is the following: "What costs can reasonably be expected to be avoided by a retail provider when part of the retail service is offered instead on a wholesale basis for resale." If there is a reasonable expectation costs will be avoided or not incurred, then those costs should properly be classified as avoided costs.

Q. What question have AT&T and MCI answered instead with their studies?

A. The question AT&T and MCI have answered with these studies is: "What costs would never be incurred at all by an entirely wholesale provider?" Any such costs are treated in their studies as "avoidable".

AT&T and MCI are mixing up the issues of costing for resale services on the one hand with unbundled service costing on the other. This approach might be appropriate if the LEC supplier offered only wholesale unbundled services, but is not an appropriate way to approach the avoided retail cost problem.

Q. Is there another way to state the right question about avoided costs?

A. Yes, the question could also be set up as: "What costs are avoided when the LEC offers only retail and wholesale bundled services, without any unbundled service offerings." This perspective on the problem can help to maintain focus on the costs avoided in connection with offering bundled services for wholesale, as required by Dr. Selwyn's and other definitions of wholesale services.

Q. Does the Commission require GTE to offer a bundled local service for resale which is identical to its own retail offering?

A. Yes. Since GTE is required to offer all of the same features and functions on a bundled local service whether sold on a wholesale basis or a retail basis, GTE cannot avoid 100 percent of the cost to support those required functions.

Q. Can you give an example of a feature that GTE is required to offer on a bundled local service?

A. Yes. GTE's retail basic local service offers a free call allowance for directory assistance. Therefore, the same call allowance must be included with the basic service when it is offered for resale.

Q. Would you please describe the analysis you have performed in Dr. Selwyn's avoided cost study?

A. Yes. I have revised Dr. Selwyn's study in two steps, correcting only those assumptions in the studies which derive from the flawed assumption that "GTE will exit the retail services market entirely."

In the first step, I corrected the treatment of Customer Service expenses. The corrections are documented in

Attachment DEW-1 to my testimony. As discussed below, this single correction reduces Dr. Selwyn's avoided cost statistic from 22.8 to 12.7 percent.

Q. What is the second step in your analysis of Dr. Selwyn's study?

A. In the second step, I have corrected the remainder of the proposed allocations in the studies that were based on inappropriate fundamental "exit retail" assumptions. These corrections result in avoided cost statistics of 9.1 percent as discussed below, and are documented in Attachment DEW-2 to my testimony.

Q. Would you please elaborate on the first step in your analysis, which you said was undertaken to correct the treatment of Customer Services expenses?

A. Yes. As shown below, Customer Service expenses were viewed as predominantly avoidable in Dr. Selwyn's study.

Account	Expense	Avoided Percent Dr. Selwyn
6621	Call Completion Services	93.75
6622	Number Services	85.50
6623	Customer Service	96.50

None of the costs recorded in Account 6621 for call completion services can be avoided; these are the costs associated with providing operator services. Likewise, none of the costs recorded in Account 6622 for number services can be avoided; these are the costs of providing directory listings and directories. Whether GTE provides basic local service on a retail basis, or on a wholesale basis for resale, the same costs are incurred in either scenario to provide operator services and directory services. In a fully unbundled local service environment, the assessment might well be different, but in the instant case of a resale environment, there is clearly no way to reasonably expect that any of these costs can be avoided.

Likewise, a large part of the costs recorded in Account 6623 for customer services are not avoided in a resale scenario. At a minimum, the ongoing GTE activities to maintain the mechanized street address guide file, as well as all customer service expenses associated with interexchange carriers, should clearly not be treated as avoided. I used the data contained in Dr. Selwyn's testimony[4] to segregate these functions and correct the avoided cost allocators used in the studies.

Q. Are the results of all of these changes documented in your Attachment DEW-1?

A. Yes. Attachment DEW-1 presents Dr. Selwyn's study results along with the results of changing <u>only</u> the customer service expense "avoided retail percentages" on lines 17, 18 and 19.[5] The subsequent support and overhead expenses

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[4] Selwyn Testimony Exhibit, Table 3, page 5 of 5. Function codes 2E94 and 2E92, all functions with an "ICSC" description, and CABS function codes 120E and 1200 represent, at a minimum, the customer service activities that cannot be avoided.

[5] Attachment DEW-1, page 1 is a summary of the results of Dr. Selwyn's own study metho[illegible] pages 2 and 3 document the allocation of the expense ca[illegible]es defined as relevant [illegible]

(contin[illegible]

allocators are automatically revised through the study's formulas, in response to the identified changes in customer service allocators.

Q. Based on the significance of this error, is it likely that the results presented by Dr. Selwyn are understated, or that there are offsetting understatements of costs somewhere else, as he suggests? (AT&T/MCI, Selwyn, p. 29, ll. 1-15.)

A. No, it is unlikely that there could be any offset for an error of this magnitude inherent in Dr. Selwyn's study. In fact, the second step in my analysis addresses a series of further corrections to his study that similarly eliminate costs from consideration as avoided costs, though none is as significant as the customer services expense issue.

Q. Would you please describe the conclusions you reached through the second step of your analysis of these two studies?

A. Yes. Following is a list of the allocation issues addressed through further changes in the allocators used in the two avoided cost studies:

1. Product management expense will not be avoided, since a retail product must be available for resale.
2. Avoided Sales expense will be considerable, but

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[5](...continued) of the studies; and page 4 documents the development of suc: and overhead allocation factc:s according to each author's formulas. None of the formu.at.on of the study has been changed.

will not reach 100 percent since some wholesale sales activity will be necessary.

3. Product advertising expense will not be avoided.

4. Dr. Selwyn should use the data available from GTE's filing to calculate the appropriate uncollectibles factor, rather than using Pacific data as a proxy.

5. Dr. Selwyn's assignment of Maintenance Expenses is out of proportion with the intended identification of costs associated with support assets. Avoided maintenance expense should be identified from the Other Property, Plant and Equipment subaccount using the general overhead factor, and the resulting composite maintenance expense factor used to identify the avoided portion of all other avoided plant-related expenses, i.e., depreciation, return and taxes.

6. Dr. Selwyn's treatment of access expenses should be corrected to reflect that none of the costs are avoided.

All of these changes, as well as the Customer Services expense correction previously discussed, are documented in Attachment DEW-2 to my testimony As discussed below, this series of corrections further reduces Dr. Selwyn's avoided cost statistic to 9.1 percent.

In making these corrections, I have not altered the algorithms in the study model, e er though I do not agree that the methodology used is an acceptable method for defining avoided costs. I have merely changed the application of the avoided cost allocators within the models as they were designed.

Q. What are the areas you made adjustments to in your analysis of Dr. Selwyn's proposal?

A. I have adjusted product management expense, sales expense, product advertising expense, and maintenance expense.

Q. Would you please elaborate on the reasons why you state that product management expenses will not be avoided?

A. Product management expenses are incurred to evaluate and bring new products to market for the LECs' retail customers and offer these same products on a wholesale basis to CLCs. Resellers do not need to duplicate these expenses as the product is already available. Therefore, product management expenses are not avoided.

Q. Would you please explain the rationale for the change you proposed for the treatment of sales expenses?

A. It is unreasonable to expect that there will not be any expenses of selling to a reseller. Competition may even initiate sales efforts in search of wholesale marketshare. The allocator I have substituted for sales expense on Attachment DEW-2 was developed based on relationships between sales expenses and revenues for total California operations.

Q. Would you please elaborate on the reasons why you state that product advertising expenses will not be avoided?

A. Yes. The avoided cost allocator for product